No. 194

IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

PAUL E. MYERS, ET AL.,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

REPLY BRIEF FOR PETITIONERS

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FOREWORD

Pursuant to paragraphs 3 and 4 of Rule 40, there being no disagreement between the parties with the presentation of items (a), (b), (c) and (d) in their respective briefs, petitioners will omit the restatement of same in this their reply brief.

The respondent states the question in his Answer Brief in Opposition in language substantially as stated by petitioners. Accordingly, the only difference between the petitioners and the respondent, and the only question which has been presented for decision in this case is, whether the gain assessed by respondent in 1954 against petitioners upon their repossession of capital assets (depreciable real property) sold under an executory contract, in 1952, was ordinary income or long term capital gain, the capital

assets having been owned by petitioners for more than six months before their sale.

Petitioners brought four cases in the Tax Court, two for the redetermination of taxes assessed upon the payments of purchase money received on the land contract in 1952 and 1953, as ordinary income and two for a redetermination of the taxes assessed upon the gain on repossession in 1954, also as ordinary income. In the Tax Court respondent conceded that the payments in 1952, 1953 and 1954 were less than the basis of the petitioners in the real property sold and were not taxable in the years in which the payments were received. The two cases involving the payments of purchase money received by petitioners were not appealed from. In the two cases involving gain on repossession the Tax Court and the United States Court of Appeals for the Sixth Circuit sustained the respondent, holding the gain to be taxable as ordinary income, and our petition for certiorari is directed to the latter two cases.

The gain on repossession was assessed by respondent under the provisions of Section 39.44-4 of Regulations 118, the pertinent portion of which Section is as follows:

> "If the vendor has retained title to the property and the purchaser defaults in any of his payments, and the vendor repossesses the property, the difference between (1) the entire amount of the payments actually received on the contract and retained by the vendor plus the fair market value at the time of repossession of fixed improvements placed on the property by the purchaser and (2) the sum of the profits previously returned as income in connection therewith and an amount representing what would have been a proper adjustment for exhaustion, wear and tear, obsolescence, amortization, and depletion of the property during the period the property was in the hands of the purchaser had the sale not been made will constitute gain or loss, as the case may be, to the vendor for the year in which the property is repossessed."

In the Tax Court and in the Court of Appeals, the respondent took the position that the gain on repossession assessed under the above formula in these cases was not entitled to capital gain treatment for the reason that the transaction between taxpayers and their purchaser was not a sale within the meaning of Sec. 117(a)(4) of the Revenue Code of 1939, (Re-enacted verbatim in the Code of 1954—26 U. S. C. 1958 ed. Sec. 1222. Respondent's App., page 8). Respondent (at footnote 2, page 4 of his brief) now appears to agree with petitioners that the sale was executory—title was retained pending the payment of the deferred semi-annual payments, which is exactly the type of transaction—deferred payment sale where title was retained, described in the above Sec. 39.44-4 of Regulations 118. It would seem that the issue in the case had been resolved, however, the respondent now denies that Section 39.44-4 of Regulations 118 or the new Regulation, Section 1.453-6(b) which was promulgated to implement the 1954 Code, are applicable to determine petitioners' gain and argues that the gain, still taxed as ordinary income, arose from a subsequent agreement under which petitioners regained possession of the property and retained the payments.

ARGUMENT

This case originally involved gain to the petitioners on the repossession of capital assets (depreciable real property) which they sold for $50,000.00 in 1952 by the terms of an executory land contract on deferred payments, whereby title was retained by the petitioners until the purchaser made full payment of the purchase price. During the third tax year (December 1954) the purchaser defaulted and the property was repossessed in depreciated condition and unimproved by the purchasers during the period of their possession.

The purchaser had paid to petitioners during the three years, 1952, 1953 and 1954, the sum of $8,750.00 on the purchase money.

The respondent assessed taxes against petitioners upon gain on this repossession (as appears in his deficiency letter of March 6, 1958—R. 28a) "under Section 453 of the Internal Revenue Code of 1954, computed as follows:

Payment received under contract	$8,750.00
Less: Depreciation on property in hands of purchaser	780.00
Total profit on repossession	$7,970.00
Distribution: (Ordinary income)	
Paul F. and Dora Jane Myers	$3,985.00
Estate of Charles W. Myers, deceased, Paul F. Myers, Administrator, and Blanche C. Myers, surviving wife	$3,985.00"

An examination of the pertinent part of Section 453 of the Internal Revenue Code of 1954, which part is included in the Appendix hereto, page 10, will disclose that no provision is made therein for gain on repossession. The language of Section 44(b) of the Revenue Code of 1939 which relates to installment and deferred payment sales of real

property is very similar to Section 453 of the 1954 Code. It will also be noted that it does not make provision for gain on repossession. (The pertinent part of Section 44(b) is set out in the appendix of this brief at page 9).

Section 44(b) of the 1939 Code was implemented by Section 39.44-4 (referred to in Foreword) of Regulations 118 and therein appears the formula for determining gain or loss in deferred payment sales of real property where title was retained by the vendor, if the purchaser defaults in any of his payments and the vendor repossesses the property.

It thus appears that the respondent in March 1958, applied the formula in Section 39.44-4, above, to assess gain on repossession. Section 1.453 of the Regulations under the 1954 Code had not been promulgated at that time and did not become effective until September 18, 1958, some six months later. But now respondent denies that the Regulations under the 1939 Code or the 1954 Code apply to petitioners' case.

Petitioners are at a loss to understand the change in position of the respondent who now states, in his Brief of Opposition, (footnote 3, page 5), that the provisions of Section 39.44-4 of Regulations 118, relative to gain on repossessions are not applicable to petitioners' case, "since the repossession took place in 1954, regulations under the 1954 Code are effective."

In the text of his argument on page 5, respondent also states that "the Regulations under the 1954 Code, Section 1.453.6 which are equivalent to those cited by petitioners, do not apply. They are applicable only to deferred payments sales * * * when the title is retained * * * and then only where the payments received during the taxable year

in which the sale is made exceed 30 percent of the selling price." (The down payment in 1952 in petitioners' land contract was but $5,000.00 or 10 per cent of the selling price.

Thus, according to respondent at this time, there was no regulation in effect in December 1954 which authorized him to compute gain on such a repossession.

Our view, however, is to the contrary. The contents of Section 44 of the 1939 Code and Section 453 of the 1954 Code are similar in most respects as to the matters with which we are concerned. T. D. 6091, C. B. 1954-2, 47, made all existing regulations under prior law which are not inconsistent with the Internal Revenue Code of 1954, effective until superseded by new regulations. Moreover Section 1.453 of the Regulations is not interpretative, but is of a legislative nature, making a change in the law it implements and a change in an existing regulation, and would therefore seem not entitled to be given retroactive effect.[1] Accordingly, Sec. 39.44-4 of Regulations 118 would be effective until September 18, 1958, when Sections 1.453-1 to 1.453.10 of regulations to implement Section 453 of the 1954 Code were promulgated in T. D. 6314, dated September 17, 1958, and published in the issue of the Federal Register for September 18, 1958, 23 F. R. 7210.

If, however, the Court should hold with the respondent on this point—that there was no effective regulation under which gain or loss on repossession could be computed in December 1954,—then we submit that the question in the

[1] Section 39.44-4 of the Regulations 118 relates to deferred payment sales where the payments in the year of sale are less than 30 percent. Section 453 of the 1954 Code also relates to deferred payment sales where the payments in the taxable year of sale do not exceed 30 percent, while Regulation 1,453-6 implementing Sec. 453, relates only to sales of real property in which the payments received during the year of sale exceed 30 percent of the selling price.

case, namely, whether the gain on repossession is ordinary income or long term capital gain, becomes moot. Under the respondent's present hypothesis of this case, he was without authority to assess gain on repossession and tax it as ordinary income under Section 453 of the 1954 Code. We know of no tax law or other regulation which provides that the recapture of possession of one's own property depreciated and unimproved, results in taxable income.

To maintain consistency and support the decisions of the Tax Court and the Court of Appeals, which he states are correct, respondent resorts to a fiction to attempt to make the purchase money received in 1952, 1953 and 1954 taxable in 1954. The respondent says that the contract was rescinded and the contract of sale was rendered ineffective from the beginning. Presumably the parties would thereupon be entitled to be placed in the same position they were had the contract not been made. This would mean paying back all the purchase payments and also the interest payments which have been taxed as ordinary income in the years received agreeable to respondent and without objection by the petitioners. Since the contract was terminated in 1954, the respondent must reason that the failure of petitioners to repay these sums and the retention thereof would constitute income to them in that year. The fallacy in such reasoning is, that the payments are not new money. He is still dealing with the purchase money payments which the Tax Court has said were not taxable income. The Tax Court did not say, and neither did the Commissioner when he assessed these payments in the years received, that they were to be held in abeyance to see what happened to the land contract and then ring them up in the cash register and return them as income, if appropriate.

CONCLUSION

Petitioners find themselves in an anomalous position trying to maintain the applicability of a regulation which the respondent disavows. If the regulation is applicable, then we submit that the gain from repossession as assessed thereunder is taxable as long term capital gain for the reasons given in our opening brief. It is a portion of the proceeds from the sale of capital assets. If the regulation in question is not applicable, the question in the cases is moot, as we stated earlier in this brief. The respondent was without authority to assess gain on repossession. Hence his assessment was void and there is no tax due from petitioners by reason of such assessment.

Petitioners having fully replied to the arguments of respondent, renew their request that their petition for a writ of certiorari be granted.

Respectfully submitted,

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APPENDIX

Excerpt from Section 44 of the Internal Revenue Code of 1939:

SEC. 44. INSTALLMENT BASIS.

(a) Dealers in Personal Property.—Under regulations prescribed by the Commissioner with the approval of the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit realized or to be realized when payment is completed bears to the total contract price.

(b) Sales of Realty and Casual Sales of Personalty.—In the case (1) of a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year), for a price exceeding $1,000.00 or (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or in the case the sale or other disposition was in a taxable year beginning prior to January 1, 1934, the percentage of the selling price prescribed in the law applicable to such year), the income may under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" means the payments received in cash or property other than evidences of indebtedness of the purchaser during the taxable period in which the sale or other disposition is made.

Excerpt from Section 453 of the Internal Revenue Code of 1954.

SEC. 453. INSTALLMENT METHOD

(a) Dealers in Personal Property.—Under regulations prescribed by the Secretary or his delegate, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

(b) Sales of Realty and Casual Sales of Personalty.—

(1) General Rule.—Income from—

(A) a sale or other disposition of real property, or

(B) a casual sale or other casual disposition of personal property (other than property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year) for a price exceeding $1,000. may (under regulations prescribed by the Secretary or his delegate) be returned on the basis and in the manner prescribed in subsection (a).

(2) Limitation.—Paragraph (1) shall apply—

(A) In the case of a sale or other disposition during a taxable year beginning after December 31, 1953 (whether or not such taxable year ends after the date of enactment of this title), only if in the taxable year of the sale or other disposition—

(i) there are no payments, or

(ii) the payments (exclusive of evidences of indebtedness of the purchaser) do not exceed 30 percent of the selling price.

(B) In the case of a sale or other disposition during a taxable year beginning before January 1, 1954, only if the income was (by reason of section 44 (b) of the Internal Revenue Code of 1939) returnable on the basis and in the manner prescribed in section 44 (a) of such code. * * *